



# **Bridging Distance for Economic Activity in Remote Places**

An eBay Study of Online Trade Liberalization by The Canary Islands

# Contents

## 03 [Introduction](#)

## 04 [Canary Islands Against the Tide](#)

04 [Moving away from protection](#)

05 [Towards growth based on openness](#)

## 06 [Towards a New Model of Internationalization](#)

06 [Reducing the cost of distance](#)

08 [But being remote is still a cost](#)

## 09 [Policy Reform for Technology-Enabled Trade](#)

10 [De minimis as trade liberalization](#)

## 15 [Conclusion](#)

## 18 [Methodology](#)

## 20 [Resources](#)

# Introduction

Since 2011, the eBay Public Policy Lab and a team of economists at Sidley Austin LLP (Sidley) have worked together to examine how globalisation and technology can empower small enterprises and promote a more inclusive and robust economy. Covering more than 50 countries, we have studied the creation, internationalization and growth of enterprises using the eBay Marketplace.

We have found that national and global opportunities have expanded beyond traditional large corporations as even the smallest Internet-enabled enterprises can connect directly with customers around the world. This is driven by the dramatic reduction in the cost of engaging in commerce over distance when a firm is enabled by the Internet, technology and online platforms.

When technology reduces trade costs, it meaningfully dissociates the ability to take advantage of economic opportunities from the location of a firm or individual. Our research shows that across advanced and emerging economies, small platform-enabled businesses are equally equipped to serve customers worldwide. We have also found significant platform-based business creation and commercial activity in areas otherwise underserved by the traditional economy. Technology thus bridges distance for commerce, something that especially benefits communities outside of capitals, populous areas and wealthy regions.

This report presents research on the effects a recent trade policy change has had on online commerce to and from a remote region. In July 2017, the Canary Islands' low value threshold, the so-called de minimis below which imports are exempt from local sales tax and customs paperwork, was raised; this reform is part of a strategy to internationalise the islands' economy and aims to strengthen consumer purchasing power. We have studied the effect this policy change has had on eBay transactions to and from the Canary Islands. We have also looked at the effect the 2016 increase of the US de minimis had on online sales from the Canaries. Finally, we have simulated the effect that a (hypothetical) reciprocal increase of the EU de minimis would have on Canary online sales.

Our research confirms that trade policy actions that lower the costs of remotely accessing markets can have a positive impact on online imports and exports in distant regions. We find that a de minimis policy change has the same effect on online commerce as a unilateral reduction of tariffs has on traditional trade: an increased de minimis boosts both online imports and exports. Our research also suggests that a reciprocated increase of the de minimis by the islands' key export destination markets, notably the EU, would further expand the positive impact of market opening among the Canary micro and small enterprises.

Governments and international organisations that want to harness the Internet, technology and online platforms for inclusive and sustainable development focused on micro and small enterprises should look to the Canary Islands as

## About the eBay Public Policy Lab

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The eBay Public Policy Lab seeks to address the public policy challenges that lie at the nexus of technology, commerce and inclusive economic opportunities. We conduct innovative research using unique data analytics methodologies and creative insights. We seek to inspire debate at the highest levels of public policy discourse about the future of commerce and how technology can be leveraged to achieve the best possible outcomes for all.

**Brian Bieron**  
Executive Director

**Hanne Melin**  
Director  
Global Public Policy

**Alan Elias**  
Senior Manager  
Global Public Policy

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This report uses eBay's own proprietary data to build on the EIG's proprietary analysis of publicly available data provided by the U.S. Census Bureau. This report is the sole product of eBay and is not produced in partnership with the EIG.

a test case. The Canaries' policy reform is based on a modern view of world trade where individuals and small businesses are empowered to participate thanks to technology; and it is responding to how technology is changing the conditions of world trade by facilitating for the islands' consumers and enterprises to embrace the change.

A small and remote region going against the current trend of advanced economies using tightened consumption tax enforcement to protect domestic retail markets should receive supportive reaction by the EU, the World Trade Organization (WTO) and organizations that promote market-based, inclusive economic development. This report therefore concludes with suggestions for how these organizations and governments should act. It also reminds that the notion of import de minimis does not itself serve the purpose of facilitating online commerce by small, remote and independent businesses or increasing consumer welfare. Nevertheless, as the research presented in this report shows, increasing the de minimis level can have that effect by reducing direct costs in destination markets. This raises the question whether we should look for other tools in addition to increased de minimis to ensure that remote, small and independent traders are not subject to misdirected taxes in destination markets.

## Canary Islands Against the Tide

### Moving away from protection

The Canary Islands, made up of seven islands, are an autonomous community of Spain. The Canaries have their own Government, Parliament and Administration. The Canaries are also one of the EU's nine "Outermost Regions" because of the islands' insularity, distance from mainland Europe and lack of raw materials.

As an Outermost Region, the Canary Islands enjoy a special economic and fiscal regime. For example, the Canaries are allowed to apply tax differentials between certain locally manufactured products and imported products as part of a strategy for social and economic development of the islands (a tax called Arbitrio sobre las Importaciones y Entregas de Bienes, AIEM).<sup>2</sup> This type of measure to protect domestic manufacturing and sales is justified at EU level by reference to the constraints of the Canaries: dependence on tourism; high transportation and production costs; small market size; and low level of export activity.

However, such a development model with its key element of market protection has not led to sustainable economic growth for the whole of the Canary Islands. The Canaries have historically faced higher unemployment, lower GDP per capita, and lower entrepreneurship and innovation levels compared to Spain and/or the EU average.<sup>3</sup>

### Outermost Regions

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Outermost Regions are islands, archipelagos and landlocked territories that are separated from the mainland EU but belong to the EU territory. EU law and all the rights and duties associated with EU Membership applies. However, Article 349 of the Treaty on the Functioning of the EU provides for "specific measures", for instance in the area of taxation or state aid, to address the challenges of respective region. Outermost Regions benefit from Cohesion Policy funding.

See: [http://ec.europa.eu/regional\\_policy/en/policy/themes/outermost-regions/](http://ec.europa.eu/regional_policy/en/policy/themes/outermost-regions/)

“We need to gradually change our economic model away from a dependence on tourism towards innovation and knowledge in industry.”

—

Fernando Clavijo Batlle,  
President of the Government  
of the Canary Islands<sup>1</sup>

When Fernando Clavijo Batlle became President of the Government of the Canary Islands in 2015, he therefore put urgency into an ongoing reform of the Canary economic model. The political focus is now on diversification and internationalization of the economy in order to reduce dependence on tourism, increase exports, and attract foreign investments and entrepreneurs.<sup>4</sup> Progress has been made. The outlook for 2018 suggests that the economy is in a turnaround with forecasted GDP growth, job creation, and business confidence.<sup>5</sup>

## Towards growth based on openness

The Canaries form part of the EU Customs Union but are not part of the EU territory for the purpose of Value Added Tax (VAT). This means that, while the Unified Customs Code applies to the Canaries, the harmonized rules on VAT do not apply; instead, the Canaries impose a sales tax (Impuesto General Indirecto Canario, IGIC) on the supply of goods and services in the Canaries by traders and professionals as well as for imports. Imports are thus subject to both IGIC and AIEM taxes.

In June 2017, the local Canary Government forced through a reform with the central Spain Government to facilitate imports, in particular through online commerce, and thereby strengthen consumer purchasing power. The Canary Islands' de minimis for imports was raised from EUR 22 to EUR 150. This means that products of a value below EUR 150 are exempt from IGIC (though still required to pay AIEM if applicable) and, in case of products from the EU, also from filing a complete customs declaration (the "Single Administrative Document"). The Canary Government commented that this measure, together with the removal of the obligation to file a customs declaration, will "greatly facilitate purchases from abroad through e-commerce from the Canary Islands by eliminating administration and costs for many products".<sup>6</sup>

The increase in the de minimis in 2017 followed on the heels of a 2016 reform to exempt low value imports (at that time still based on the threshold of EUR 22<sup>7</sup>) from the obligation to file a customs declaration. This reform was "one of the steps taken in the process of searching for the best solution for imports made through electronic commerce and remote sales".<sup>8</sup> A next big step was taken one year later, raising the de minimis to EUR 150.<sup>9</sup>

This is an exceptional move in today's global political environment where we are seeing increased protectionism especially targeting remote, Internet-enabled micro and small business traders in the form of imposing consumption or sales taxes more aggressively in the destination market. The EU and Australia are two advanced economies that are moving to eliminate their long-standing de minimis levels in order to apply domestic VAT and sales tax to small, independent, remote retailers – taxes that are appropriately applied to local merchants who gain meaningful benefits from their local business operations.

The Canary Islands is a small, distant region that goes against this harmful trend: the Canaries are unilaterally opening up their domestic market to trade. In contrast to much of the current political discourse, the Canary Government seeks to promote growth and consumer welfare through openness to trade and by specifically targeting a market access cost that harms remote businesses.

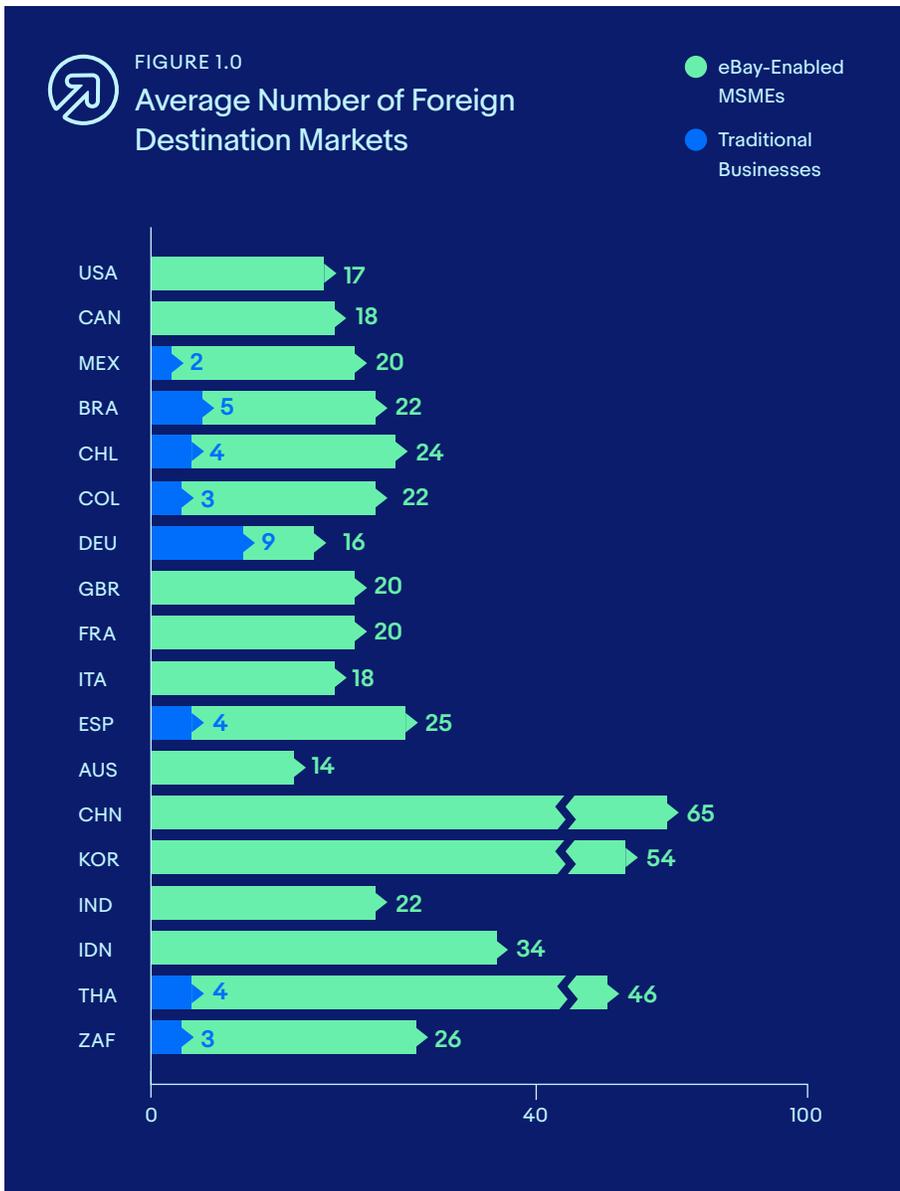
## **Towards a New Model of Internationalization**

The Canary Government describes the reform as boosting online imports and the purchasing power of consumers. In a broader context, an increase of de minimis for customs duties and local taxes should be viewed as trade policy for small internet-enabled businesses. As the research presented in this report shows, it is for remote market access a policy measure equivalent to tariff reductions.

### **Reducing the cost of distance**

Conventional arms-length trade has traditionally not been an option for most small businesses, and Global Value Chains have so far been incapable of supporting a meaningful number of Micro Small and Medium sized Enterprises (MSME) across the globe. The Internet coupled with technology-based services is presenting a new and complementary model of internationalization with significant potential for micro and small enterprises in particular.

For instance, the online commerce platform is proving a very effective way for independent online small business to directly serve customers in different and distant markets. We find that the eBay marketplace empowers exporting, largely by very small independent firms, in both advanced and emerging countries to an average of about 27 different countries in a year.<sup>10</sup> In both the US and Europe, we see how the online commerce platform enables economic activity, such as exporting and enterprise creation, across well-off as well as underserved counties and regions.<sup>11</sup>

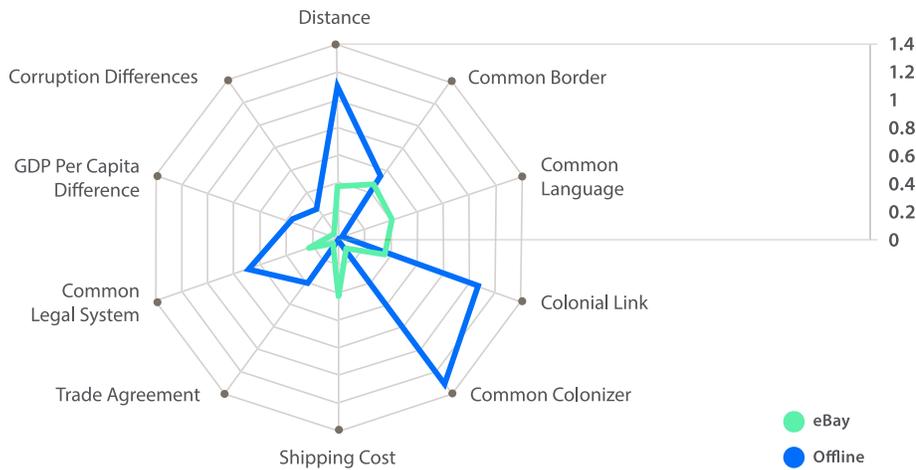


**Figure 1.0**

The eBay data reflects the average number of different foreign markets reached in 2015 by eBay-Enabled MSMEs. The available traditional business data comes from World Bank Exporter Dynamics Database.

For details, see [https://www.ebaymainstreet.com/sites/default/files/ebay\\_global-report\\_0.pdf](https://www.ebaymainstreet.com/sites/default/files/ebay_global-report_0.pdf)

Online commerce is a practical and efficient way for small businesses to expand their market reach geographically. The costs associated with traditional trade models or with serving customers through a network of physical facilities are prohibitive. Compared to traditional international trade, Lendle et al have found that distance has a much lower negative impact on firms transacting cross-border in the online marketplace.<sup>12</sup> Similarly, a 2013 report by the European Commission’s Joint Research Center concludes that distance matters far less online.<sup>13</sup>



**Figure 2.0**  
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**Most Trade Costs Matter More Offline Than Online**

Developed by Lendle (2012), this figure represents the various trade costs and factors studied as part of a distance analysis of international trade. The analysis found that all the traditional trade costs and institutional factors, with the two exceptions of shipping costs and no common language, matter less for eBay-enabled trade than they do for offline trade.

Our estimates, based on a global data set, suggest that distance matters 83% less for international eBay transactions compared to traditional transactions.<sup>14</sup> This is mostly due to the way the online commerce platform dramatically reduces costs of marketing, communication and information in remote markets. For sure, costs related to small-volume package shipping and remote customer service remain significant challenges to micro and small businesses also in the platform model of trade.<sup>15</sup>

According to the World Economic Forum (WEF), platform-based commerce has had a strong positive impact on many MSMEs, by both opening up new export avenues and facilitating access to low-cost imported inputs.<sup>16</sup> WEF explains that online marketplaces have made selling and sourcing internationally much easier by reducing many non-tariff barriers to trade, most importantly, access to information. The International Trade Centre points out that cross-border online commerce provides a unique opportunity to micro and small enterprises in isolated locales that historically have had trouble reaching even regional markets.<sup>17</sup>

### But being remote is still a cost

Technology tools are increasingly ubiquitous and large retail incumbents, in particular in advanced economies, employ similar tools to those that are lowering commerce barriers for the micro enterprise. Many large merchants combine technology with a physical facilities network, adopting an omni-channel business strategy, which tells us that local facilities combined with Internet and mobile technology tools are viewed as the most competitive way of attracting and serving customers.

Internet-enabled traders, in particular those located in underprivileged communities, regions and even national markets, are in many cases inherently disadvantaged in relation to local merchants in privileged markets: without a local facility but with shipping costs and delays, they attempt to serve distant customers, who generally prefer domestic offerings and service.

Online commerce has not tipped the playing field in favor of the small and remote; it has presented a way for the uncounted small enterprises historically locked out of global commerce to crack through previously insurmountable barriers and internationalize on their own terms.

A minimal de minimis for local duties and taxes operates as a market access barrier for remote small firms by applying taxes traditionally imposed on local retail services providers to completely remote firms unable to offer similar services in the taxing jurisdiction. Not surprising, small firms have been found less capable of adjusting their prices to the destination market when faced with additional costs than large firms are. For instance, an empirical study suggests that large exporters would raise their export prices three times more than small firms when faced with a depreciation in the home currency and only small firms would be unable to adjust further when also faced with import tariffs.<sup>18</sup>

The conclusion is that, for micro and small businesses to be able to take advantage of technology for growth and expansion, it is not enough to ensure these firms are connected, have access to global online marketplaces and payment services, and can use effective and affordable delivery solutions. Any extra costs imposed in the destination market will aggravate their disadvantage as remote and small businesses. This is why increasing the de minimis for customs paperwork, local duties and taxes should be seen as a critical trade and development policy to promote more inclusive trade and broader based economic growth.

## Policy Reform for Technology-Enabled Trade

Harnessing new technologies and integrating into an increasingly global economy has been a hallmark of prospering societies. Indeed, technological progress and openness to trade are the two most important drivers of economic development.<sup>19</sup> At the same time, trade has grown because of how technology and policy together reduce trade costs.<sup>20</sup> As an illustration of this: our research suggests that the online commerce platform reduces trade costs by about 83%; while estimates suggest that full implementation of the Trade Facilitation Agreement will cut WTO members' trade costs by an average of 14.3%.<sup>21</sup>

In the best of worlds, policy reforms will help to stimulate technological changes, and technological changes put pressure on policies.<sup>22</sup> This is what we are seeing on the Canary Islands. The Canary Government has implemented a trade policy to raise the de minimis so that imports valued less than EUR 150 are exempt from the obligation of IGIC and, in the case of EU imports, of a customs declaration. This Canary trade policy is specifically aimed at facilitating online commerce, which is generally characterized by high volumes of lower value shipments. The measure lowers the costs for foreign enterprises to remotely serve the islands' consumers; of course, it also lowers the costs for the islands' businesses importing inputs valued below EUR 150.

“Trade and technology are vital sources of economic growth”

—  
WTO Director-General Roberto Azevedo Foreword to World Trade Report 2017

The research presented in this section supports previous studies of the effects that unilateral as well as reciprocated market opening may have on an economy. It suggests that a raised de minimis indeed has the effect the Canary Government is seeking: lowered importation barriers supports both consumer welfare and local businesses. The research also suggests that lowered importation barriers in key destination markets would further boost the internationalization of the Canary Islands' enterprise population.

## De minimis as trade liberalization

The trade literature finds that unilateral trade liberalization increases the variety of imports available to domestic firms and households. For consumers, this may mean increased welfare in terms of lower prices and a broadened range of available goods. As a benchmark for such potential consumer benefits from liberalized trade, Lendle et al (2012) have predicted the consumer welfare gains from lowering trade costs to the level estimated for online commerce platforms.<sup>23</sup> They find that, across 56 different countries, it would result in an increase in real income by 29% on average, with the largest welfare gains in remote countries.<sup>24</sup>

The Canary Government is explicitly seeking to increase purchasing power by the islands' consumers through lower trade costs for online commerce. The Canaries being a remote area, **the sizeable boost of 6% in online imports** that our research finds attributable to the raised de minimis suggests there is potential for greater consumer welfare on the islands.

Trade literature also states that unilateral trade liberalization should trigger higher exports. The lowering of import tariffs can benefit domestic producers through cheaper imported inputs, which in turn would make their exports more competitive and/or increase the variety of exports.<sup>25</sup>

The Canary trade policy of a higher de minimis could already be supporting, for instance, the islands' production and design of clothes, such as swimwear, and increasing that industry's competitiveness in world markets. Our research findings suggest that the increase in the de minimis has had a positive impact by increasing Canary online exports by 8%.

However, to ensure a comprehensive and inclusive boost to the islands' mostly micro and small enterprises, key destination markets such as the EU should reciprocate this trade liberalization reform of raised de minimis. Recent OECD research suggests that the benefits from market opening are larger when more countries are involved. Market opening should be reciprocated in order to support a country's domestic production (through cheaper inputs), consumer spending as well as exports.<sup>26</sup> **Our estimates suggest that a reciprocal increase by the EU of its de minimis on VAT could increase Canary online exports to mainland EU consumers by about 8%.**

Moreover, when we compare the 2016 and 2017 Canary trade policy changes we find that the greatest effect is achieved when the de minimis level is raised and exempts both customs paperwork and taxation. Traditional trade facilitation is focused on cutting red tape at the borders. However, our appraisal suggests that direct costs in the destination market have a significant impact on online commerce.

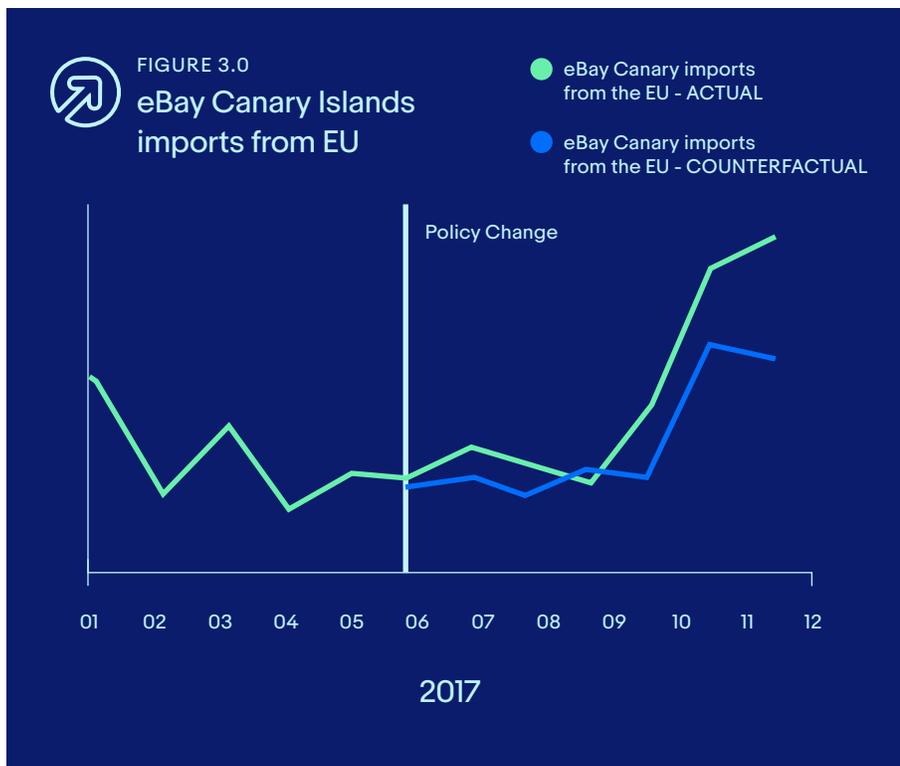
In conclusion, our analysis of the Canary increase of the de minimis points to it being, for online transactions, a measure equivalent to reducing trade tariffs with the potential of strengthening consumer purchasing power and stimulating trade by small internet-enabled businesses.

## Detailed findings:

### 1. Benefitting online imports

We have studied the effect that the increased de minimis has had on purchases by eBay buyers on the Canary Islands from eBay sellers in the EU. We used a so-called event study technique to assess whether variations in eBay transactions over time can be attributed to that trade policy change (see Appendix for details on the methodology).

We find that the de minimis increase had a statistically significant and measurable effect on eBay Canary imports from EU of goods with a transaction value below EUR 150. Our assessment suggests that, during the six-month period following the policy change (i.e. July to December 2017), such online imports increased by about 6% per month on average as a direct result of the trade policy change.



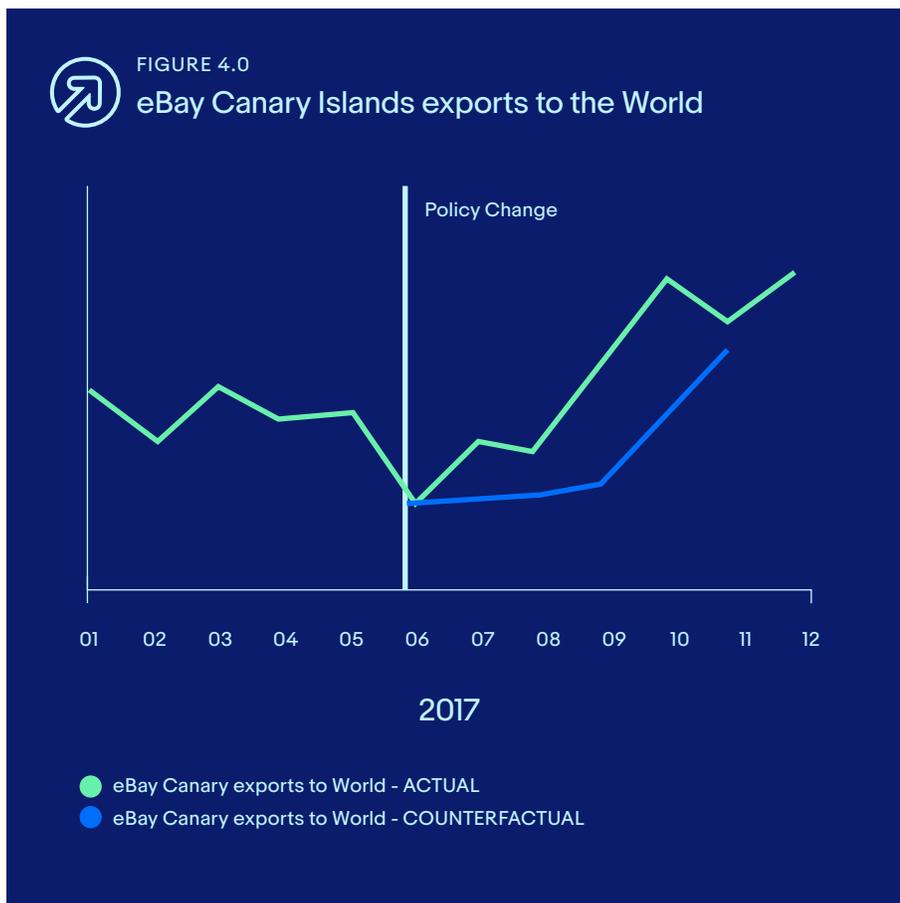
**Figure 3.0**

The green line shows the actual eBay Canary Islands imports. The blue line shows the counterfactual (hypothetical) time-series of monthly eBay Canary Islands imports from EU of goods with transaction values below EUR 150 that would have existed in the absence of the de minimis increase. The difference between the green and blue lines expresses the effect that the policy change has unfolded after its implementation

## 2. Benefitting online exports

Using the event study technique, we have also studied the effect that the increased de minimis had on Canary online exports. We find that the de minimis increase had a statistically significant and measurable effect on sales by eBay sellers on the Canaries to eBay buyers anywhere in the world.

Our assessment suggests that, during the six-month period July to December 2017, eBay Canary exports increased by about 8% per month on average as a direct result of the policy change.



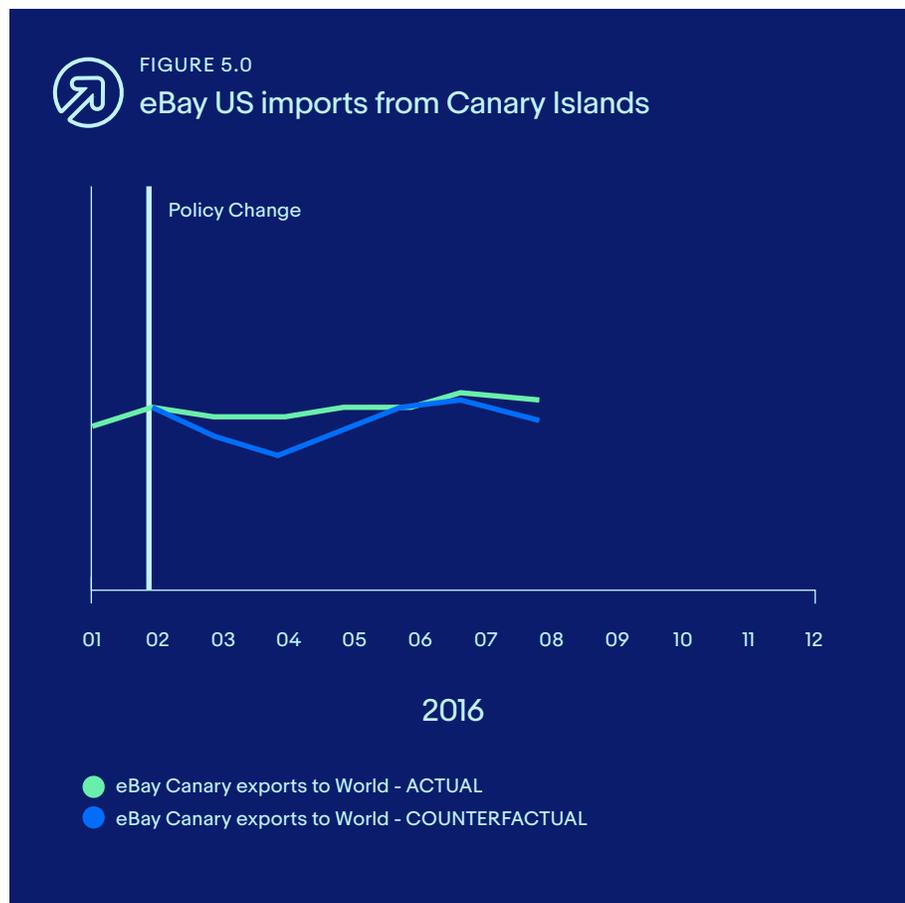
**Figure 4.0**

The green line shows the actual eBay Canary Islands exports. The blue line shows the counterfactual (hypothetical) time-series of monthly eBay Canary Islands exports to the world that would have existed in the absence of the de minimis increase. The difference between the green and blue lines expresses the effect that the policy change has unfolded after its implementation.

## 3. In further support of online exports

We have so far studied the effect of the Canary Islands' trade policy reform of raising the de minimis. Our research suggests that it has had a positive impact on both online imports and exports. This indicates that increasing the de minimis is for remote internet-enabled businesses the equivalent of lowering tariffs. The corollary is that Canary small businesses would benefit from higher de minimis abroad. As an attempt to approximate the effect a policy change, for instance in the EU, could have for online exports from a remote region, we have looked at the impact the increase by the US of its de minimis has had on Canary eBay exports.

In March 2016, the US raised its de minimis for customs duties and taxes from USD 200 to USD 800.<sup>27</sup> We have studied the effect of this policy change on Canary eBay sellers to US eBay buyers. We find that the US policy change had a statistically significant and measurable effect on eBay Canary exports to the US. During the six-month period March to September 2016, eBay Canary exports to the US of goods of a transaction value below USD 800 increased by about 9% on average per month as a direct result of the increase in the de minimis. This is in line with the effect we see that the Canary policy change has had on the islands' online imports and exports.



**Figure 5.0**

The green line shows the actual eBay Canary Islands exports. The blue line shows the counterfactual (hypothetical) time-series of monthly eBay Canary Islands exports to the US with transaction value below USD 800 that would have existed in the absence of the de minimis increase. The difference between the green and blue lines expresses the effect that the policy change has unfolded after its implementation.

#### 4. Estimating the effect of a reciprocal EU policy change

We have carried out a simulation of what it might mean for Canary online exports if the EU raised its de minimis to EUR 150.

We estimated the EU eBay export reaction to the increased US de minimis and compared with the Canary eBay export reaction to the same de minimis increase; doing so allowed us to identify what we call a “remoteness multiplier”. The remoteness multiplier captures the fact that online exports from a remote region like the Canary Islands are more sensitive to a trade (tariff) policy change than

mainland EU online exports are. By applying the remoteness multiplier to the above reported response by EU eBay exports to the Canary Islands de minimis change, we were able to estimate the Canary online export response to a reciprocal EU policy change.

Our assessment suggests that Canary online exports would increase by 8% on average per month if the EU would raise its de minimis to EUR 150.

## 5. Appraising the impact of different de minimis changes

We have looked at the impact on online commerce of the two de minimis policy changes by the Canary Government. In 2016, the Canary Government changed the scope of the de minimis to also cover the obligation to file a customs declaration. Prior to this 2016 change, the de minimis of EUR 22<sup>28</sup> covered only the domestic sales tax IGIC and all imports were subject to customs declaration. In 2017, the Canaries then raised the de minimis level from EUR 22 to EUR 150. The current de minimis rule thus covers both IGIC and customs paperwork for EU imports, while only IGIC for non-EU imports, below the value of EUR 150.

Our assessment suggests that, during the six-month period following the policy change in August 2016, eBay Canary imports from the EU increased by about 2.5% per month on average as a direct result of extending the scope of the de minimis rule to cover also customs procedure. The 2017 change of the de minimis level then resulted in a considerable increase of eBay Canary imports from the EU by about 6% and from non-EU countries by about 3.5% (note that the findings for non-EU imports are not statistically significant<sup>29</sup>).



Traditional trade facilitation is focused on cutting red tape at the borders, not on direct costs in the destination market. For instance, paragraph 8.2 of the 2017 WTO Trade Facilitation Agreement explicitly excludes internal taxes, such as VAT, from the scope of the obligation to provide for customs de minimis rules. Our high level appraisal of the effect of the Canary Government's two de minimis policy changes suggests that

- the de minimis threshold needs to be at a certain level to have an impact
- the de minimis exemption should cover both customs paperwork and local taxes to maximize the impact on online commerce

This implies that trade facilitation for small, online traders should extend to direct costs in destination markets, such as sales / consumption taxes.

## Conclusion

This report presents research suggesting that increasing the de minimis for taxes and customs has a positive effect on online commerce in distant regions. Online commerce in a distant region is stimulated by both unilateral and reciprocated increased de minimis. This is because domestic and foreign market opening complement each other by supporting the competitiveness of domestic production as well as facilitating remote market access.

These are significant findings. Their importance and relevance are to be understood in the context of how technology is transforming global commerce. Today, the very smallest Internet-enabled enterprises can expand beyond local and even national markets to remotely serve customers worldwide. For the first time in history, micro and small firms are able to participate in world trade as independent companies. But this is not trade as we know it. It is small firms selling directly to customers in a large number of foreign markets without a local presence.

Global, online and remote commerce by small firms is easily weighed down by costs in the destination markets as those firms compete with locally based merchants. Trade facilitation for this type of commerce therefore requires measures that go beyond cutting red tape at the border.<sup>30</sup> The research presented in this report should inform discussions on what trade facilitation needs to encompass in order to also reach Internet-enabled, remote, small and independent traders.

The Canary Islands case study confirms two things. First, remote online commerce is boosted by reduced costs in the destination markets. This is effectively achieved through an exemption from local consumption/sales tax. Second, online commerce to and from a distant, and economically disadvantaged, region is boosted by such a reduction in costs. The overwhelming majority of small firms are

not fortunate to be located in central economic hubs. Therefore, if the purpose is indeed “helping MSMEs to join trade flows in greater numbers”<sup>31</sup>, trade facilitation needs to encompass the issue of local taxation of remote small traders.

The EU should apply this report’s findings to its policies on regional economic development, starting with Outermost Regions, Overseas Countries and Territories, and developing countries to reverse a trend of increased market access costs for remote small traders.

- 1. Outermost Regions** - The EU could exempt online commerce from certain Outermost Regions to the EU mainland from VAT as a specific measure pursuant to Article 349 of the Treaty on the Functioning of the EU (TFEU). This would be relevant for those regions outside of the EU VAT rules, such as the Canary Islands.<sup>32</sup>
- 2. Overseas Countries and Territories (OCT)** - The EU could also exempt from VAT online commerce from certain OCTs to the EU mainland in pursuit of the objectives of Article 198 of the TFEU, notably promoting the economic and social development of the OCTs. This would serve as a complement to current unilateral trade preferences and development funding.
- 3. Sustainable Development** - Finally, the EU could use its Economic Partnership Agreements with African, Caribbean and Pacific countries to facilitate online, remote commerce from those countries (by small firms) into the EU through an exemption from VAT.

Governments around the world should use this report’s findings to progress discussions on how to facilitate MSME trade. The WTO could be the arena for that.

- 4. Work Program** - The newly formed Informal Working Group on MSMEs at the WTO<sup>33</sup> could address sales/consumption taxes in destination markets as part of its work program as an issue pertaining to reduction of trade costs for MSMEs and of “particular interest to MSMEs that could be addressed in WTO Trade Policy reports”<sup>34</sup>.
- 5. Plurilateral Negotiations** - Likeminded countries<sup>35</sup> could explore innovative mechanisms to address local taxation of remote online commerce, for instance through a de minimis plurilateral agreement.<sup>36</sup> Such an agreement would be negotiated among a coalition of countries; each member country would commit to ratcheting up its de minimis levels of a set period of time in exchange of similar commitments from the other member countries. The mechanics would be the same as that governing tariff reductions in trade agreements. The agreement could be accompanied by support for impact assessment, capacity building for MSMEs to leverage online commerce, etc. Such a plurilateral mechanism for increasing de minimis levels could later on be multilateralized.

## Overseas Countries and Territories

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There are 25 **Overseas Countries and Territories (OCT)** recognized by the Treaty on the Functioning of the EU, four without a permanent local population. OCTs depend constitutionally on the EU member states Denmark, France, the Netherlands and the UK but, in contrast to Outermost Regions, they do not form part of the EU territory. They are not directly subject to EU law but benefit from associate status. There is a “reciprocal partnership” between the EU and the OCTs to support sustainable development of the OCTs, and they are considered belonging to the same “European family”. Especially, trade related cooperation should contribute to economic sustainable and social development. See the Overseas Association Decision 2013/755/EU.

Our research also confirms that minimizing and simplifying customs processes have a positive effect on online commerce. We conclude that to accelerate global online commerce and thereby broaden trade participation to internet-enabled, independent MSMEs, governments need to intensify trade facilitation efforts also in the area of digitizing customs processes.

6. A coalition of the willing, ideally the EU and developing countries with assistance from organization like the World Bank and UNCTAD, could develop programs for customs modernization focused on remote online commerce by MSMEs. Such programs could be built around :
  - A digital customs portal that allow exporters to easily generate parcel accompanying documents as well as a one-stop shop for contact with customs officials.
  - “Trusted eTrader” status could be achieved by the MSMEs through use of the portal, where recording of e.g. customs documents would go to demonstrating customs and security compliance over time.
  - A public-private dialogue to map out the appropriate risk management models for online trade by MSMEs.

In ending, it is worth remembering that de minimis is a valuation ceiling that seeks to strike a balance between customs revenue and costs when collecting taxes and processing low value and low risk consignments. It follows that de minimis thresholds are not set to serve the purpose of facilitating online commerce by small, remote and independent busiessses or increasing consumer welfare. Nevertheless, raising the de minimis level can have that effect: it gives a boost to online commerce, as this report has shown.

However, it is not the de minimis level itself, but the absence of indirect and direct costs that boosts online commerce. This raises the question whether we should look for other tools than de minimis to ensure that remote, small and independent traders are not subject to misdirected taxes in destination markets. This could take the shape of multilateral or plurilateral agreements to lower taxes on the products of remote micro and small businesses to promote inclusive trade, economic growth and development.

# Methodology

The analysis carried out by Sidley for this report is based on datasets covering all eBay transactions (exports and imports) between the Canary Islands and the world for the period 2012 to 2017.

Sidley has used a well-known econometric technique from the class of “Before/After” approaches – a so-called “event study” – for the purpose of analyzing the effects that the increase in the de minimis has had on transactions by eBay buyers and sellers on the Canary Islands.

## The idea of an event study is to apply time-series techniques in order to:

- Detect whether there are statistically significant changes in the historical data, i.e., whether an “event” has really occurred.
- Assess whether such changes can be attributed to the policy change at issue (in this case, to the de minimis increase).

## An event study consists of three parts:

1. **Estimation** - Estimate an accurate model of economic performance in the period prior to the policy change in question (in this case, prior to the de minimis increase).
2. **Simulation** - Construct the proper “counterfactual” by forecasting the economic time-series that would have prevailed in the absence of the de minimis increase, applying the estimation model (see previous point) to the post-implementation period.
3. **Comparison** - Determine size of the difference between the observed (actual) economic performance and the estimated (counterfactual) economic performance during the post-implementation period, and determine whether this difference is statistically different from zero.

## Model specifics

### A. Assessment of the historical effect of de minimis change

Sidley implemented the event study by applying a Seasonal Autoregressive Integrated Moving Average (SARIMA) model. The SARIMA model provided an answer to the question how the relevant economic metrics (i.e., imports and exports) would have evolved in the absence of the de minimis policy intervention, and whether the difference between the actual and the counterfactual is statistically significant. The SARIMA Model also allows the researcher to control for temporal and seasonal dynamics.

Sidley used this model to forecast a time series of monthly eBay transactions for three situations with control variables for each one:

- 1. Canary Islands imports from the EU** – For the period 29 June 2017 to 29 December 2017, Sidley forecasted a series of monthly imports by eBay buyers in the Canary Islands from eBay sellers in the EU, each transaction with a value of less than EUR 150. Imports by eBay buyers in Spain from eBay sellers in the EU were used as a control variable.
- 2. Canary Islands exports to the world** – For the period of July 2017 to December 2017, Sidley forecasted total monthly exports by eBay sellers in the Canary Islands to eBay buyers in the rest of the world (including the EU). Spain’s offline exports of consumption goods to the EU was used as a control variable.<sup>37</sup>
- 3. Canary Islands exports to the US** – For the period of March 2016 to August 2016, Sidley forecasted monthly exports by eBay sellers in the Canary Islands to eBay buyers in the US, each transaction with a value of less than USD 800. Sidley used two control variables: (i) eBay Canary Islands’ total exports to the world<sup>38</sup> and (ii) the nominal USD/EUR exchange rate<sup>39</sup>.

## **B. Assessment of a hypothetical effect of de minimis change by the EU**

Sidley also estimated the effect that a hypothetical increase of the EU de minimis would have on eBay exports by sellers in the Canary Islands to buyers in the EU.

To that end, Sidley first assessed how exports by eBay sellers in Spain and Portugal to eBay buyers in the US developed as a result of the 2016 change in the US’ de minimis. We compared this reaction to the reaction in exports by eBay sellers in the Canary Islands to eBay buyers in the US to the same 2016 change of the US de minimis. We found that eBay transactions from the Canary Islands were more sensitive to tariff changes, by a factor of 1.314, than those from Spain and Portugal to the same policy change. We used this factor to calibrate the reaction in exports by eBay sellers in the EU to eBay buyers in the Canary Islands to the change in the de minimis of the Canaries. This gave us the result that a hypothetical increase in the EU de minimis would boost transactions between eBay Canary sellers and eBay EU buyers by 8.18%.

# Resources

- <sup>1</sup>Canary Islands Newsweek, Elite Reports, June 2017.
- <sup>2</sup>Council Decision 377/2014/EU of 12 June 2014 on the AIEM tax applicable in the Canary Islands.
- <sup>3</sup>European Commission, Summary Assessment of the Canary Islands, November 2013.
- <sup>4</sup>Canary Islands Newsweek, Elite Reports, June 2017.
- <sup>5</sup>European Commission, Regional Innovator Monitor: <https://ec.europa.eu/growth/tools-databases/regional-innovation-monitor/base-profile/canary-islands>
- <sup>6</sup>Own translation of press release by the Canary Islands Government, 27 June 2017: <https://www.octsi.es/octsi/noticias-del-octsi/150-euros-exencion-igic-importacion>
- <sup>7</sup>The threshold for consumer to consumer imports from the EU were at EUR 110 and from rest of the world at EUR 45.
- <sup>8</sup>Resolution of 2 July 2017 by the Agencia Tributaria Canaria: “La Orden de 29 de julio de 2016, por la que se suprimió la obligación de presentar el Documento Único Administrativo, para la declaración de los tributos a la importación exigibles en los envíos de escaso valor, ha sido uno de los pasos dados en el proceso de búsqueda de la mejor solución para las importaciones efectuadas a través de comercio electrónico y de ventas a distancia”, <https://www.octsi.es/images/documentos/2017/resolucion-atc-2017-despacho-envios-bajo-valor-exentos-igic.pdf>
- <sup>9</sup>Our understanding is that the 2017 reformed LVT of EUR 150 covers both private and professional imports; imports from EU are exempt from both IGIC and customs declarations whereas imports from 3rd country are exempt from IGIC as the Canary Islands form part of the Customs Union.
- <sup>10</sup>See eBay report, “Small Online Business Growth Report: towards an inclusive global economy”, Summer 2017, [https://www.ebaymainstreet.com/sites/default/files/ebay\\_global-report\\_0.pdf](https://www.ebaymainstreet.com/sites/default/files/ebay_global-report_0.pdf)
- <sup>11</sup>See eBay reports “Platform-Enabled Small Businesses and the Geography of Recovery: evidence of more inclusive new enterprise growth on eBay than reflected in official statistics”, January 2017, [https://www.ebaymainstreet.com/sites/default/files/ebay\\_report\\_county-growth\\_0.pdf](https://www.ebaymainstreet.com/sites/default/files/ebay_report_county-growth_0.pdf) and “Towards a More Regionally Inclusive Economy: an eBay study of the contributions regions make to total enterprise growth in the UK and Germany”, January 2018, [https://www.ebaymainstreet.com/sites/default/files/ebay\\_report\\_uk-germany\\_v652.pdf](https://www.ebaymainstreet.com/sites/default/files/ebay_report_uk-germany_v652.pdf)
- <sup>12</sup>“There Goes Gravity: How eBay Reduces Trade Costs”, by Andreas Lendle, Marcelo Olarreaga, Simon Schropp, Pierre-Louis Vezina, Pierre-Louis, in World Bank Policy Research Working Paper No. 6253, October 2012.
- <sup>13</sup>“The drivers and impediments for cross-border e-commerce in the EU”, by Estrella Gomez, Bertin Martens and Geomina Turlea (European Commission, Joint Research Center), Digital Economy Working Paper 2013/2: “the results show that the importance of geographical distance is strongly reduced in online trade, compared to offline trade, due to a drastic reduction in information costs in the digital economy that enables consumers to scan a much wider territory to satisfy their wishes and place their buying orders”.
- <sup>14</sup>See eBay’s report “Commerce 3.0 for Development”, 2013, available [https://www.ebaymainstreet.com/sites/default/files/eBay\\_Commerce-3.0-Development.pdf](https://www.ebaymainstreet.com/sites/default/files/eBay_Commerce-3.0-Development.pdf)
- <sup>15</sup>See Figure 2.1 illustrating the impact various transaction costs have on traditional and platform-enabled trade (pages 6-7). “Small Online Business Growth Report: towards an inclusive global economy”, an eBay report, Summer 2017, [https://www.ebaymainstreet.com/sites/default/files/ebay\\_global-report\\_0.pdf](https://www.ebaymainstreet.com/sites/default/files/ebay_global-report_0.pdf)
- <sup>16</sup>“What Companies Want From the World Trading System”, World Economic Forum, 2015, available at [http://www3.weforum.org/docs/WEF\\_GAC\\_Trade\\_II\\_2015.pdf](http://www3.weforum.org/docs/WEF_GAC_Trade_II_2015.pdf)
- <sup>17</sup>“Bringing SMEs onto the E-Commerce Highway”, International Trade Center, 2016, available at: <http://www.intracen.org/publication/Bringing-SMEs-onto-the-e-Commerce-Highway/>
- <sup>18</sup>“Pricing-to-market, Trade Policy, and Market Power”, by Alan Asprilla, Nicolas Berman, Olivier Cadot, and Melise Jaud, Graduate Institute Geneva, Working Paper Series, 23 March 2015.
- <sup>19</sup>“Technology, trade and jobs”, WTO World Trade Report 2017.
- <sup>20</sup>The volume of trade increased 27-fold between 1950 and 2006. “The Political Economy of the World Trading System: from GATT to WTO”, Bernard M. Hoekman, Michel M. Kostecki, 3rd Edition 2009, Oxford University Press
- <sup>21</sup>WTO news, 22 February 2018, [https://www.wto.org/english/news\\_e/news18\\_e/fac\\_22feb18\\_e.htm](https://www.wto.org/english/news_e/news18_e/fac_22feb18_e.htm)
- <sup>22</sup>“The Political Economy of the World Trading System: from GATT to WTO”, Bernard M. Hoekman, Michel M. Kostecki, 3rd Edition 2009, Oxford University Press
- <sup>23</sup>Lendle et al (2012) estimated that trade costs (i.e. the effect of distance) are 65% lower for international transactions on the eBay marketplace compared to traditional trade.
- <sup>24</sup>“There Goes Gravity: How eBay Reduces Trade Costs” (October 2012), by Andreas Lendle, Marcelo Olarreaga, Simon Schropp, Pierre-Louis Vezina, Pierre-Louis, in World Bank Policy Research Working Paper No. 6253.
- <sup>25</sup>“The Political Economy of the World Trading System: from GATT to WTO”, Bernard M. Hoekman, Michel M. Kostecki, 3rd Edition 2009, Oxford University Press
- <sup>26</sup>“Market opening, growth and employment”, OECD Trade Policy Papers No. 204, April 2018.

- <sup>27</sup> See press release of 11 March 2016 by US Customs and Border Protection, <https://www.cbp.gov/newsroom/national-media-release/de-minimis-value-increases-800>
- <sup>28</sup> The de minimis level for consumer-to-consumer imports was EUR 110 from the EU and EUR 45 from rest of the world.
- <sup>29</sup> The results for the eBay Canary imports from non-EU countries are not statistically significant, i.e. the effect of the policy change cannot be established at the conventional confidence levels below 5% or 10%. However, the finding is close to being significant at a 20% confidence level.
- <sup>30</sup> Traditional trade facilitation as covered by the WTO Trade Facilitation Agreement encompasses efforts such as simplifying required paperwork, modernizing procedures and harmonizing customs requirements (see e.g. [https://www.wto.org/english/tratop\\_e/tradfa\\_e/tradfa\\_introduction\\_e.htm](https://www.wto.org/english/tratop_e/tradfa_e/tradfa_introduction_e.htm) )
- <sup>31</sup> Speech by WTO Director General Roberto Azevêdo, 31 October 2017, [https://www.wto.org/english/news\\_e/spra\\_e/spra196\\_e.htm](https://www.wto.org/english/news_e/spra_e/spra196_e.htm)
- <sup>32</sup> Guadeloupe, French Guiana, Martinique, Reunion, Mayotte and Saint-Martin are also Outermost Regions to which EU VAT rules do not apply.
- <sup>33</sup> This initiative was announced at the 2017 WTO 11th Ministerial Conference in Buenos Aires: [https://www.wto.org/english/news\\_e/news17\\_e/minis\\_13decl7\\_e.htm](https://www.wto.org/english/news_e/news17_e/minis_13decl7_e.htm)
- <sup>34</sup> Joint Ministerial Statement, Declaration on the Establishment of a WTO Informal Work Programme for MSMEs, WTO 13 December 2017, WT/MIN(17)/58.
- <sup>35</sup> Friends of E-Commerce for Development and Friends of MSMEs.
- <sup>36</sup> This idea has been elaborated on by Dr. Kati Suominen in “The Silver Bullet for Fueling Small Business Exports in the E-Commerce Era: A Plurilateral on De Minimis”, April 2017, <https://katisuominen.files.wordpress.com/2017/04/de-minimis-plurilateral-suominen-april-2017.pdf>
- <sup>37</sup> Eurostat.
- <sup>38</sup> Canary Islands Statistical Office: Estadística de Comercio Exterior de Canarias / Series mensuales. Canarias. 2000-2017. (Metodología 2011); available online at <http://www.gobiernodecanarias.org/istac/jaxi-istac/menu.do?uripub=urn:uuid:a19805e5-1674-4efd-b047-1ab0abac9c36>.
- <sup>39</sup> European Central Bank data. [https://www.ecb.europa.eu/stats/policy\\_and\\_exchange\\_rates/euro\\_reference\\_exchange\\_rates/html/eurofxref-graph-usd.en.html](https://www.ecb.europa.eu/stats/policy_and_exchange_rates/euro_reference_exchange_rates/html/eurofxref-graph-usd.en.html)

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